

SALARY REDUCTION SIMPLIFIED EMPLOYEE PENSION (SARSEP)

Listing of Required Modifications and Information Package (LRMs)
(For use with prototype SEPs intending to satisfy the
requirements of Code § 408(k)(6).)

This information package contains samples of plan provisions that satisfy certain specific requirements of the Internal Revenue Code, as amended through the Internal Revenue Service Restructuring and Reform Act of 1998 (P.L. 105-206). Such language may or may not be acceptable in specific plans, depending on the context. A prototype sponsor applying for an opinion letter on a prototype salary reduction simplified employee pension ("SARSEP") in accordance with Revenue Procedure 91-44, 1991-2 C.B. 733, must satisfy these LRMs in addition to the LRMs for regular, non-elective SEPs.

We have prepared this package to assist sponsors who are drafting SARSEPs. To expedite the review process, sponsors are encouraged to use the language contained in this package.

Underlined material reflects changes to the 7-91 version of these LRMs.

A prototype SARSEP may not be used by an employer who: (1) did not maintain a SARSEP on December 31, 1996; (2) at any time during the prior plan year had more than 25 employees who would have been eligible to participate; (3) has any leased employees within the meaning of Code § 414(n)(2); (4) is a governmental or tax-exempt entity; or (5) has eligible employees whose taxable year is not the calendar year.

SEPs submitted under the "short amendment" procedure described in § 5.03 of Rev. Proc. 91-44, must include at least the information contained in LRM #s I through VII, except where specifically stated otherwise.

SEPs submitted under the "long amendment" procedure pursuant to § 5.04 of Rev. Proc. 91-44 must include the appropriate information contained in each of these LRMs, according to whether they have chosen to be considered "deemed top-heavy" or "not deemed top-heavy."

Under each type of submission, the sponsor must certify that it has complied with the applicable notice requirements outlined in §§ 4.03 and 4.04 of Rev. Proc. 91-44.

I. Statement of Requirement: Purpose, Code § 408(k)(6), Rev. Proc. 91-44.

Sample Plan Language:

This is an amendment to the employer's existing salary reduction simplified employee pension ("SARSEP") that is intended to qualify under Code § 408(k)(6) and any guidance issued thereunder.

The employer agrees to permit elective deferrals to be made that will be contributed by the employer to the individual retirement account or individual retirement annuity ("SEP-IRA") established by or on behalf of each participant to accept contributions made under this SARSEP.

II. Statement of Requirement: Participation and Coverage Requirements, Code § 408(k)(6)(A) and (B).

Sample Plan Language:

1. Elective deferrals shall be permitted for a plan year only if:

(a) not less than 50 percent of the employees eligible to participate elect to have amounts contributed to the SEP on their behalf; and

(b) the employer had no more than 25 employees at all times during the prior plan year who were eligible to participate in the SEP.

2. If the 50-percent requirement is not satisfied as of the end of any plan year, all the elective deferrals made by employees for that plan year shall be considered "disallowed deferrals," i.e., IRA contributions that are not SEP-IRA contributions. The employer shall notify each affected employee, within 2 1/2 months after the end of the plan year to which the disallowed deferrals relate, that the deferrals are no longer considered SEP-IRA contributions. Such notification shall specify the amount of the disallowed deferrals and the calendar year of the employee in which they are includible in income and must provide an explanation of applicable penalties if the disallowed deferrals are not withdrawn in a timely fashion.

(The following language, or similar language, must be included for long amendment submissions.)

3. The notice to each affected employee must state specifically:

(a) The amount of the disallowed deferrals;

(b) That the disallowed deferrals are includible in the employee's gross income for the calendar year or years in which the amounts deferred would have been received by the employee in cash had he or she not made an election to defer and that the income allocable to such disallowed deferrals is includible in the year withdrawn from the SEP-IRA; and

(c) That the employee must withdraw the disallowed deferrals (and allocable income) from the SEP-IRA by April 15 following the calendar year of notification by the employer. Those disallowed deferrals not withdrawn by April 15 following the year of notification will be subject to the IRA contribution limitations of Code §§ 219 and 408 and thus may be considered an excess contribution to the employee's IRA. Disallowed deferrals may be subject to the 6-percent tax on excess contributions under Code § 4973. If income allocable to a disallowed deferral is not withdrawn by April 15 following the year of notification by the employer, the income may be subject to the 10-percent tax on early distributions under Code § 72(t) when withdrawn.

Disallowed deferrals are reported in the same manner as are excess SEP contributions.)

III. Statement of Requirement: Allocation of and Limits on Elective Deferrals, Code §§ 402(h)(2), 404(h), 408(k)(6) and 415.

(Note to Reviewer: The plan must provide a means by which an employee who is eligible to participate in the SARSEP can elect to have the employer make payments either (1) as contributions to the SEP-IRA of each eligible employee in accordance with a salary reduction agreement or (2) to the employee directly in cash.)

1. Allocation of Elective Deferrals. The employer shall contribute to each employee's SEP-IRA the amount of elective deferrals chosen by the employee.

2. Salary Reduction Agreement Option. An employee may elect to have elective deferrals made under this SEP through either single-sum or continuing contributions, or both, pursuant to a salary reduction agreement.

3. Amount of Elective Deferrals. An employee may elect to have his or her compensation reduced by the following percentage or amount per pay period, or for a specified pay period or periods, as designated in writing [CHECK ONE]:

[] An amount not in excess of [] percent of an employee's compensation.

[] An amount not in excess of [\$] of an employee's compensation.

4. Cash Bonus Option. An employee may base elective deferrals on cash bonuses during the year that, at the employee's election, may be contributed to the SEP or received by the employee in cash. [] Check here if such elective deferrals may be made under this SEP.

5. Timing of Elective Deferrals. No deferral election may be based on compensation an employee received, or had a right to receive, before execution of a salary reduction agreement by the employee.

6. Under no circumstances may an employee's elective deferrals in any calendar year exceed the lesser of 15 percent of his or her compensation (determined without including the SARSEP contributions), or the limitation under Code § 402(g) based on all of the plans of the employer.

(The following two sentences, or similar language, must be included for long amendment submissions.)

The deferral limit is 15 percent of compensation (less employer SARSEP contributions). Compute this amount using the following formula: Compensation (before subtracting employer SARSEP contributions) x 13.0435%

7. If an employer maintains any other SEP to which non-elective SEP employer contributions are made for a plan year, or any qualified plan to which contributions are made for such plan year, then an employee's elective deferrals may be limited to the extent necessary to satisfy the maximum contribution limitations under Code § 415(c)(1)(A).

(The following two sentences, or similar language, must be included for long amendment submissions.)

In addition to the dollar limitation of Code § 415(c)(1)(A), which is \$30,000 for 2000, contributions under this SEP, when

aggregated with contributions to all other SEPs and qualified plans of the employer, generally may not exceed 25 percent of compensation for any employee. If these limits are exceeded on behalf of any employee for a particular plan year, that employee's elective deferrals for that year must be reduced to the extent of the excess.)

8. Each employee's elective deferrals under this SEP may be based only on the first \$150,000 of compensation (as adjusted for increases in the cost of living in accordance with Code § 401(a)(17)(B).)

IV. Statement of Requirement: Excess Contributions, Code §§ 408(k)(6)(C) and (F), and 4979 and Reg. § 54.4979-1.

Sample Plan Language:

1. Elective deferrals by a highly compensated employee must satisfy the deferral percentage limitation under Code § 408(k)(6). Amounts in excess of the deferral percentage limitation will be deemed excess SEP contributions on behalf of the affected highly compensated employee or employees.

2. The employer shall notify each affected highly compensated employee, within 2 1/2 months following the end of the plan year to which the excess SEP contributions relate, of any excess SEP contributions to the highly compensated employee's SEP-IRA for the applicable year. Such notification shall specify the amount of the excess SEP contributions and the calendar year in which the contributions are includible in income and must provide an explanation of applicable penalties if the excess contributions are not withdrawn in a timely fashion.

(The following language, or similar language, must be included for long amendment submissions.

3. Excess SEP contributions are includible in the employee's gross income on the earliest dates any elective deferrals made on behalf of the employee during the plan year would have been received by the employee had he or she originally elected to receive the amounts in cash. However, if the excess SEP contributions (not including allocable income) total less than \$100, then the excess contributions are includible in the employee's gross income in the year of notification. Income allocable to the excess SEP contributions is includible in the year of withdrawal from the SEP-IRA.

4. If the employer fails to notify any of the affected employees within 2 1/2 months following the end of the plan year of an

excess SEP contribution, the employer must pay a tax equal to 10 percent of the excess SEP contribution. If the employer fails to notify employees by the end of the plan year following the plan year in which the excess SEP contributions arose, the SEP no longer will be considered to meet the requirements of Code § 408(k)(6). If the SEP no longer meets the requirements of Code § 408(k)(6), then any contribution to an employee's IRA will be subject to the IRA contribution limitations of Code §§ 219 and 408 and thus may be considered an excess contribution to the employee's IRA.

5. The notification to each affected employee of the excess SEP contributions must specifically state in a manner calculated to be understood by the average employee:

(a) The amount of the excess SEP contributions attributable to that employee's elective deferrals;

(b) The calendar year in which the excess SEP contributions are includible in gross income; and

(c) That the employee must withdraw the excess SEP contributions (and allocable income) from the SEP-IRA by April 15 following the year of notification by the employer. Those excess contributions not withdrawn by April 15 following the year of notification will be subject to the IRA contribution limitations of Code §§ 219 and 408 for the preceding calendar year and thus may be considered an excess contribution to the employee's IRA. Such excess contributions may be subject to the 6-percent tax on excess contributions under Code § 4973. If income allocable to an excess SEP contribution is not withdrawn by April 15 following the year of notification by the employer, the income may be subject to the 10-percent tax on early distributions under Code § 72(t) when withdrawn.

6. Definitions

The "deferral percentage limitation" is the maximum amount of elective deferrals, expressed as a percentage of compensation, that can be contributed on behalf of any highly compensated employee for a particular plan year and it equals the product of (i) the average of the amounts of elective deferrals (expressed as a percentage of each such employee's compensation) made on behalf of all the non-highly compensated employees for the same plan year, and (ii) 1.25. In calculating this average, the percentage for an eligible non-highly compensated employee who chooses not to have elective deferrals made on his or her behalf for a plan year, is zero.

The determination of the deferral percentage for any employee is to be made in accordance with Code § 408(k)(6) and any guidance issued thereunder.

Effective for plan years beginning after December 31, 1996, the term "highly compensated individual" shall mean an individual described in Code § 414(q) who, during the current or preceding year:

(a) Was a 5-percent owner as defined in Code § 416(i)(1)(B)(i); or

(b) Received compensation in excess of \$80,000, as adjusted pursuant to Code § 414(q)(1), and was in the top-paid group (the top 20 percent of employees, by compensation).)

V. Statement of Requirement: Restrictions on Withdrawals, Code § 408(k)(6)(F).

Sample Plan Language:

1. The employer shall notify each employee who makes an elective deferral for a plan year that, notwithstanding the prohibition on withdrawal restrictions contained in this SEP, any amount attributable to such elective deferrals which is withdrawn or transferred before the earlier of 2 1/2 months after the end of the particular plan year and the date the employer notifies its employees that the deferral percentage limitations have been calculated, will be includible in income for purposes of Code §§ 72(t) and 408(d)(1).

VI. Statement of Requirement: Top-Heavy Requirements, Code § 416.

(Note to Reviewer: Short amendment SEPs are deemed top-heavy and thus must comply with the top-heavy minimum contribution requirements whether or not the SEP is actually top-heavy. Only Sections 1 and 2 of this LRM #VI need to be contained in short amendment SEPs. Long amendment SEPs may or may not be deemed top-heavy. Long amendment SEPs which are deemed top-heavy must contain Sections 1, 2 and 3; those not deemed top-heavy should omit these sections and include the remaining sections of this LRM #VI, beginning with Section [4].

When calculating the key employee percentage as described below, the key employee's elective deferrals are counted in both the numerator and in the denominator. The key employee percentage is calculated using the fraction: (contributions/compensation x 100)%.)

Sample Plan Language:

1. Unless another plan of the employer is designated, in the space below, to satisfy the top-heavy requirements of Code § 416, the employer will make a minimum contribution each year to the SEP-IRA of each employee eligible to participate in this SEP (other than a key employee as defined in Code § 416(i)), which, in combination with other non-elective contributions, if any, is equal to the lesser of 3 percent of each employee's compensation or a percentage of such compensation equal to the percentage of compensation at which elective and non-elective contributions are made under the SEP for the plan year for the key employee for whom such percentage is the highest for the plan year.

[IF APPLICABLE, NAME THE PLAN OTHER THAN THIS SEP IN WHICH THE MINIMUM TOP-HEAVY CONTRIBUTION WILL BE MADE]

2. For purposes of satisfying the minimum contribution requirement under Code § 416, all non-elective contributions under the SEP shall be taken into account, but elective deferrals shall not be taken into account.

(The following language, or similar language, must be included for deemed top-heavy long amendment submissions.)

3. A "key employee" under Code § 416(i)(1) is any employee or former employee (and the beneficiaries of these employees) who, at any time during the "determination period", was:

(a) An officer of the employer (if the employee's compensation exceeds 50 percent of the limit under Code § 415(b)(1)(A));

(b) An owner of one of the 10 largest interests in the employer (if the employee's compensation exceeds 100 percent of the limit under Code § 415(c)(1)(A));

(c) A 5-percent owner of the employer as defined in Code § 416(i)(1)(B)(i); or

(d) A 1-percent owner of the employer (if the employee has compensation in excess of \$150,000).

The "determination period" is the current plan year and the 4 preceding plan years.

(The following language, or similar language, must be included for long amendment submissions which are not deemed top-heavy.)

[4] Unless another plan of the employer is designated in the space below to satisfy the top-heavy requirements of Code § 416, each year this SEP is top-heavy (as defined below) the employer will make a minimum contribution to the SEP-IRA of each non-key employee eligible to participate, which, in combination with other non-elective contributions, if any, is equal to the lesser of 3 percent of such employee's compensation or a percentage of compensation equal to the percentage of compensation at which elective and non-elective contributions are made under the SEP for the plan year for the key employee for whom such percentage is the largest.

[IF APPLICABLE, NAME THE PLAN OTHER THAN THIS SEP IN WHICH THE MINIMUM TOP-HEAVY CONTRIBUTION WILL BE MADE]

[5] For purposes of satisfying the minimum contribution requirement under Code § 416, all non-elective contributions under the SEP shall be taken into account, but elective deferrals shall not be taken into account.

[6] Definitions

A "key employee" is any employee or former employee (and the beneficiaries of these employees) who, at any time during the "determination period", was:

(a) An officer of the employer (if the employee's compensation exceeds 50 percent of the limit under Code § 415(b)(1)(A));

(b) An owner of one of the 10 largest interests in the employer (if the employee's compensation exceeds 100 percent of the limit under Code § 415(c)(1)(A));

(c) A 5-percent owner of the employer as defined in Code § 416(i)(1)(B)(i); or

(d) A 1-percent owner of the employer (if the employee has compensation in excess of \$150,000).

The "determination period" is the current plan year and the 4 preceding plan years.

This SEP is "top-heavy" for a plan year if, as of the last day of the previous plan year (or current plan year if this is the first year of the SEP) the total of elective and non-elective contributions made on behalf of key employees for all the years this SEP has been in existence exceeds 60 percent of such contributions for all employees. If the employer maintains (or

maintained within the prior 5 years) any other SEP or defined contribution plan in which a key employee participates (or participated), the contributions or account balances, whichever is applicable, must be aggregated with the contributions made under this SEP. The contributions (and account balances, if applicable) of an employee who ceases to be a key employee or of an individual who has not been in the employ of the employer for the previous 5 years shall be disregarded. The identification of key employees and the top-heavy calculation shall be determined in accordance with Code § 416 and the regulations thereunder.

VII. Statement of Requirement: The effective date for the SARSEP must be specified.

Sample Plan Language:

This elective SEP amendment shall be effective upon adoption.

(The following sentence must be included for long amendment submissions.)

No elective deferrals may be based on compensation an employee could have received before adoption of this elective SEP and execution by the employee of a salary reduction agreement.

(The following two LRMs must be included for long amendment submissions.)

VIII. Statement of Requirement: Deductibility of Contributions, Code § 404(h).

Sample Plan Language:

1. Contributions to the SEP are deductible by the employer for the taxable year with or within which the plan year of the SEP ends. Contributions made for a particular taxable year and contributed by the due date of the employer's income tax return, including extensions, are deemed made in that taxable year.

IX. Statement of Requirement: Contact for Adopting Employers, § 4 of Rev. Proc. 91-44.

(Note to Reviewer: The SEP must contain a statement that the sponsoring organization will inform the employer of any amendments to the SEP or if the sponsoring organization no longer sponsors this prototype.)

Also, the SEP must contain the name, address, and telephone number of the sponsoring organization or its authorized representative to which adopting employers may direct inquiries.)
